Corporate Control, Corporate Power
A Twentieth Century Fund Study

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The large corporation and its impact

A central feature of economic development during the past century has been the rise of the large corporation, both nationally and internationally, to a strategically important position. Large firms have grown enormously in absolute size, and those economic sectors dominated by large firms, such as manufacturing and utilities, have increased at the expense of other economic sectors, particularly agriculture (see Table 6.1). In the late 1970s more than 60 percent of the assets of all nonfinancial corporations in the United States were owned by companies with $250 million or greater in assets, and in the important manufacturing sector, the 200 largest firms controlled 60 percent of all assets in 1977, up from 45 percent in 1945.¹

Whether concentration and market power have increased since 1900 is still subject to debate; the changes in output composition, the increased geographic scope of markets, the higher rate of product innovation, the greater importance of advertising, and other complexities make comparisons difficult. Still, authorities on these matters agree that concentration had already attained quite high levels 75 to 80 years ago and that significant market control prevailed in many industries following the great merger movement around the turn of the century (if not before).² Thus whatever the trend of market control since 1900, its level was substantial then and is substantial in 1980. The long-established norm of market structure and behavior has been that of oligopoly, that is, the constrained rivalry of a few interdependent sellers who compete mainly by means of product differentiation.³

An economy dominated by oligopoly is one in which the market still operates, but under conditions far removed from Adam Smith's "obvious and simple system of natural liberty." The range of variations found in oligopolistic industries in degree of
competition and in the adequacy of market results is wide.\(^4\) Under some circumstances, where they are subject to competitive challenges,\(^5\) internal pressures,\(^6\) or a favorable cultural milieu, large oligopolistic firms may skillfully adapt and develop products, techniques, and social policies according to market changes and community demands. In other contexts, oligopolists may be technologically lethargic, quick to resort to restrictive practices and seek protection when subject to competitive threats, and socially and politically regressive. These differences are conspicuous among nations, but extremes of oligopoly can be found among large corporations within a given country — witness the dynamism of the computer and semiconductor businesses in the United States, on the one hand, and the lethargy of the automobile—steel—rubber tire businesses, on the other.

Lethargy is partly a function of the maturity and size of an industry, as well as of the age, size, and bureaucratic character of the dominant individual firms. Old and very large firms may lose their flexibility as a result of bureaucratisation, technological vested interests, and habituation to limited competition and protectionism.\(^7\) They may be able to get away with this — at least for a while — if their market power is great and entry barriers are substantial. They may even have enough economic and political clout, given their networks of related supplier—customer interests, to be able to command social resources that enlarge and protect such vested interests, to the long-run detriment of society at large. In the United States this point has been raised with respect to both the automobile industry\(^8\) and the "weapons culture."\(^9\)

Another urgent issue in this age of rapid technological change is the proliferation of what economists call "externalities," "spillover," or "neighborhood" effects. These are unintended impacts of production or consumption on others, effects that are excluded from the cost and revenue calculations of the originating sources; that is, they are not "internalized" and taken into account through market processes. Their importance has increased with growing numbers of people, greater economic interdependence, and an outpouring of chemicals and industrial products of uncertain environmental effect — on consumers using products containing, say, nitrates; workers absorbing new chemicals in the workplace; the general public affected by waste residues interacting with one another in the environment. Where these external effects produce deleterious results, the externalities are properly regarded as negative outputs and associated final products are underpriced and
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produced to excess. When external effects would be positive (e.g., public education, or mass inoculation by law to combat a serious contagious disease), privately produced outputs tend to be too small and overpriced. In the case of outputs designated “public goods,” external benefits are spread over many people – perhaps the entire population. Prices cannot be readily assigned or charged to such goods, like national defense and national parks, which private enterprise does not provide in economically efficient quantities. Such goods have been increasing in importance in the total spectrum of goods demanded by the public.

Problems such as negative externalities and a deficiency of public goods output are hardly attributable to the rise of the large corporation, although insofar as the large corporation has accelerated modern industrialization, has assumed industrial leadership, and wields political power, at the very least it shares responsibility as a causal agent. The large corporation may also contribute more directly to negative externalities as a result of its size, geographic dispersion, and mobility, which give it greater freedom to select technologies and business strategies that add to its internal efficiency but that may involve an unfavorable trade-off between costs and benefits to society. Nonetheless, it is clear that the problems of externalities and public goods deficiencies would not be resolved by a return to a world of small-scale enterprise. Their resolution will depend, however, on an efficient political response to the new demands that are not being met by market forces alone.

Problems that are directly associated with size and market control might be solved by a return to a world of smaller enterprise (although this is by no means certain), but size and market power are almost surely irreversible developments – society is not going to return to a small, perhaps mythically beautiful, world, barring a revolution in values and power hard to envisage emerging out of present structures and trends, or an international catastrophe that would bring a regression to mere survival. Thus room for policy maneuver may be painfully narrow. It is partly for this reason that the bulk of social commentary addressed to the large firm, its impact and reform, operates within the very limited framework of what appears to be practically possible. There are utopians at the extremes, urging massive decentralization to quasi-laissez-faire, on the one hand, and broad-scale nationalization of the commanding heights of private enterprise, on the other. But most reformers call for marginal changes that recognize current
realities; namely, that the large corporation is here to stay and that change will come through some combination of corporate initiatives, shaped to a greater or lesser degree by external pressure, and government intervention, direct and indirect.

Given the traditional economic assumptions of unrestricted competition and a goal of profit maximization, "corporate initiatives" are clear and simple and the very idea of corporate "responsiveness" is meaningless – corporate behavior will always be based on adapting available means to a profitability end. With restricted competition, however, the pressure to maximize is relieved, and it becomes possible for nonprofit goals to emerge – the monopolist may choose the "quiet life," and yet other ends may be pursued by managers, their subordinates, and employees. With the profit-maximization goal still intact, the discretion allowed by restricted competition may not be realized – the monopolist may continue to pursue a strenuous life, and any outcropping of ends incompatible with profits may be strongly discouraged or quashed by the profit-seeking control group.

Whether the profitability goal is preserved, and the intensity with which it is sought, depends not only on competitive pressures but also on who controls the corporation. The traditional assumption was that owners control, directly or through their representatives on the board of directors; the board and the top managers were either the owners themselves or controlled agents and fiduciaries obligated by law to serve stockholders' interest. This interest has been assumed to be material gain and the postulated objective has therefore been profit maximization. The rise of the large corporation, however, has been associated with a diffusion of ownership interest and an enlargement in the power and discretion of professional managers. It is widely believed, and has become part of the conventional wisdom, that there has been a "managerial revolution" during the twentieth century, characterized by a massive shift in the control of corporation from the owners to nonowning managers. If true, the question of corporate goals takes on a different complexion. The assumption of profit maximization would appear more precariously based than in circumstances of direct or assured owner control. It becomes more plausible that the managers might evolve into a new, powerful elite of technocrats who can take real initiatives and bend more flexibly to social needs.

Whatever the truth of the matter, the separation of ownership and control in the large firm has raised new questions about cor-
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Corporate goals. And the objectives of the large corporation; its internal drives, choices, and power; and its responsiveness, actual and potential, to external demands and social control are major issues today. This book is directed to these issues. The main focus is on the evolution of the control and objectives of large corporations, especially the extent to which goals and behavior have been affected by the growth in importance of professional managers in the top echelons of power, the increase in company size and bureaucratization, the evolving patterns of intercorporate linkages, and the changing role of financial institutions and government in the decision-making processes of the giant corporation.

The Modern Corporation and Private Property

The rise in importance of the large corporation and its implications for ownership and control were described in a very effective way by A. A. Berle, Jr., and Gardiner C. Means in their classic, The Modern Corporation and Private Property, first published in 1932. They portrayed an economy, in 1929 and 1930, that was already dominated by the 200 largest nonfinancial corporations, and they offered a cautious forecast of greater domination in the future, as part of a long-term trend toward increasing corporate size and centralization.

With larger corporate size comes a greater dispersion of stock ownership, a steady reduction in the power and interest of the shareholder, and a gradual enhancement of managerial authority, that is, a separation of ownership from control. This process reaches its extreme in the case of corporations subject to "management control," where effective decision-making power rests with inside officers with "negligible" ownership interests in their companies. For 1929–1930 Berle and Means found 44 percent of the 200 largest nonfinancial companies by number, 58 percent by wealth, to be subject to management control; another 21 percent by number and 22 percent by wealth were found to be controlled by a legal device. Thus the aggregate of nonownership control of large companies was 65 percent by number, 80 percent by total wealth.

Berle and Means claimed that this transformation to management control – with nominal ownership divorced completely from control and de facto power in the hands of self-perpetuating management groups – amounted to a revolutionary change in
property relations, as momentous as the shift from feudalism to capitalism. With these "new princes" in power, the link between ownership profits and the producing and investing decision-making processes was severed. Berle and Means suggested that the possible negative effects of this "splitting of the property atom" were: a diversion of resources from owners to managerial use, an unwarranted and uneconomic growth in firm size (and greater centralization) in the interests of managerial prestige and power, and an efficiency loss. These ill effects were only hinted at, and the impact of separation and centralization on the willingness to incur risk, and on price, output, investment, dividend, and borrowing policy, was not seriously discussed.

Although Berle and Means described with drama and insight the growth in the overall importance of large firms and, especially, the separation of ownership and control in the large corporation, they had almost nothing to say about the effects of these changes on market concentration and market power. At various points they even added a positive note to the list of possibilities, suggesting that the new managerial elite might well assume broader responsibilities than private profit making and bridge the gap between the narrowness of profit-seeking enterprise and the growing social needs of a complex society. But basically they did little beyond establishing the trends and rationales for these developments (obviously important subjects in their own right).

The Modern Corporation and Private Property presented ideas that had been emerging and circulating in various forms for a great many years. A significant degree of separation of ownership and control was implicit in the manipulations and rip-offs of the "robber barons" of the late nineteenth and early twentieth centuries. Many of their exploits were at the expense of creditors, but the stockholders came in for their share of victimization by insiders. In the case of the railroads, which bulked large as security issuers (and giant corporations) in the late nineteenth century, a phrase quoted by Newton Booth in 1873 was that "every tie in the road is the grave of a small stockholder." The promoters and managers of the railroads generally put in very little if any capital, extracting it from governments, bondholders, and potential railroad users cajoled into investing in their own economic interest. Under the usual plan, "the only men in the community who are absolutely certain not to contribute any money are those who own and control it when finished." In describing the struggle over control of the Erie Railroad in the late 1860s, Charles Francis
Adams, Jr., wrote that “It was something new to see a host of adventurers, men of fortune, without character and without credit, possess themselves of an artery of commerce more important than was ever the Appian Way . . .” Adams observed that the idea of any inquiries by the ordinary stockholder into the affairs of the Erie “were looked upon by the ring in control as downright impertinence.”

In the famous Pujo Committee report of 1913, the separation of ownership and control and the loss of power by the ordinary stockholder were clearly described as general characteristics of the large corporation.

None of the witnesses called was able to name an instance in the history of the country in which the stockholders had succeeded in overthrowing an existing management in any large corporation, nor does it appear that stockholders have ever even succeeded in so far as to secure the investigation of an existing management of a corporation to ascertain whether it has been well or honestly managed . . . The situation that exists with respect to the control of the so-called mutual companies is in a modified way illustrative of all great corporations with numerous and widely scattered stockholders. The management is virtually self-perpetuating and is able through the power of patronage, the indifference of stockholders and other influences to control a majority of stock.

The committee went on to discuss the ease with which bankers could control large companies, given their strategic position as promoters and lenders, and great attention was given to the power of J. P. Morgan and his close-knit coterie of commercial and investment banking associates. The maintenance of control with a limited interest in a company in the pre-World War I era was known, in fact, as the “Morgan theory” of control. According to Edwin P. Hoyt, Jr., “The principle was put into practice by J. Pierpont Morgan to suit the convenience of William Henry Vanderbilt, who wanted to safeguard his fortune by selling large blocks of New York Central Railroad stock, yet maintain control of the railroad with a minority interest. Morgan showed Vanderbilt how it could be done.”

As early as 1904 Thorstein Veblen wrote that “the management is separated from the ownership or property, more and more widely as the size of corporation finance widens,” and he made much of the conflict of interest between managers and both stockholders and the larger community. Writing on the basis of late nineteenth century experience, Veblen not only took separation as
a premise, but took the managerial norm to be the use of control for short-term transient gain. In the 1920s Veblen made less of manipulative gain but saw the conflict broaden, identifying the separable interests of the dominant financial or absentee owners, ordinary owners, hired managers who he assumed to be nonowners with a production-technological bent, and the general public bringing up the rear. The holding company was seen as having created "a more perfect order of absenteeism," with "effectual control and management . . . passed into the hands of a relatively smaller minority of the ultimate owners," with the ordinary shareholder left with "a correspondingly slighter chance of personally influencing any action taken by management." Veblen was also impressed by Morgan's financiering of mergers and holding companies and the general growth of investment banker influence in the 1890s, which provided "the means by which the needful running collusion in the further conduct of the business was to be enforced and regulated."

In the 1920s there was a great increase in the number of shareholders and a further diffusion of stock ownership. In addition, there were innovative developments in the use of nonvoting, fractional-voting, and multiple-voting stocks, and the pyramiding of intercorporate holdings to facilitate insider control, thus supplementing the advantages of top management position with various types of legal disenfranchisement of the general run of preferred and common stockholders. These developments were observed and debated at the time, and many of them were discussed with sophistication in William Z. Ripley's Main Street and Wall Street. With reference to the phenomenon of separation of management from ownership, Ripley said:

What an amazing tangle this makes of the theory that ownership of property and responsibility for its efficient, far-sighted, and public-spirited management shall be linked the one to the other. Even the whole theory of business profits, so painstakingly evolved through years of academic ratiocination, goes by the board. All the managers, that is to say the operating men, are working on salary, their returns, except on the side, being largely independent of the net result of company operation year by year. The motive of self-interest may even have been thrown into the reverse, occasionally, so far as long-time upbuilding in contradistinction to quick turn-over in corporate affairs is concerned.

J. M. Keynes also wrote with insight and prescience on these issues in the 1920s, pointing to the "tendency of big business to
socialize itself,” with shareholders “almost totally dissociated from the management” and managements more concerned with “the general stability and reputation of the institution” than with any maximizing of owner profits. “The shareholders must be satisfied by conventionally adequate dividends, but once this is secured, the direct interest of the management often consists in avoiding criticism . . .”34 He saw the large organization as vulnerable to external attacks because of its great size and semimonopolistic position. Thus Keynes gives the rudiments of a theory of meeting minimum profit standards (“satisficing” in contemporary jargon) and the basis for a doctrine of corporate responsibility. He even saw that “the same causes promote conservatism and a waning of enterprise,” with a “natural line of evolution” from a bureaucratized capitalism to state socialism. “The battle of Socialism against unlimited private profit is being won in detail hour by hour.”35 Keynes’s insights on the impact of the rise of the large corporation follow a long British tradition that goes back at least as far as Adam Smith, who wrote with vehemence on the abusive tendencies of joint stock companies and their inability to compete against “private adventurers” (i.e., smaller, owner-dominated companies) in the absence of grants of exclusive privilege.36

The triumph of managerialism

Although subject to a great deal of criticism from 1932 up to the present on the score of method, inferences, and policy conclusions, the central theme of The Modern Corporation and Private Property— that ownership and control in the large corporation have been separated, with effective discretionary power in the hands of the active management rather than stockholders— has become part of the conventional wisdom, accepted by conservatives like H. G. Mange, liberals like R. A. Gordon and J. K. Galbraith, and even Marxists like Paul A. Baran and Paul M. Sweezy.37

The management control premise, referred to here as managerialism, has spawned a wide array of hypotheses, most of them focusing on managerial objectives, behavior constraints, and performance. If managers have discretion, to what ends will they use it? Insofar as managers are free of owner constraints, and assuming that they are “economic men” trying to maximize their own net advantages, we have the basis for a theory of “expense preference” or constrained expense maximization (expenses including mana-
Other hypotheses focus on size or growth in size as corporate objectives best meeting managerial preferences. Another major line of departure from the traditional assumption of profit maximization—that of the behaviorist school of Simon, Cyert, and March—uses a managerialist premise in its theories on how organization affects business objectives and behavior. According to these analysts, firms tend to seek satisfactory rather than maximum profits, and they adapt to the pressures of environmental opportunities and threats (rather than engaging in a profit search of great and unchanging intensity). It is not clear that a high degree of separation of ownership and control, as opposed to mere large size and structural complexity, is required for the behaviorist theories, but separation fits nicely into the downgrading of the profit motive as the preeminent corporate objective.

It is also evident that the varying objectives of a managerial group could influence business performance—that is, affect prices, outputs, profits, expense ratios, payout ratios, growth rates, and the willingness to take risks and innovate—in ways that might be at the expense of some or all of the owners of the companies. A large, and inconclusive, literature has arisen on this matter. Similarly, the policy implications of these various conjectures and revisions have also been left quite vague. Those who claim to have established a case for departures from classic profit maximization have made little effort to assess the direction or magnitude of the social costs involved in these tendencies, if any, or their impact on the main drift of the corporate system as a whole, let alone appropriate policy responses.

The triumph of managerialism has also led to a process of reconciliation between it and older doctrines in conflict with or threatened by the newly established truths. For example, the discretion of management and the possibility of nonprofit-maximizing behavior call into question the efficient properties of a free market in a system of managerial enterprise. The response of some devotees of the free market has been an outright denial of the validity of the managerial hypothesis. But others have integrated it nicely into free enterprise logic via the theory of takeovers and the “market for corporate control”—inefficient managers, if not responsible to, and subject to displacement by, owners directly, can be removed by stockholders’ acceptance of takeover bids induced by poor performance and a consequent reduction in stock value. Here, reconciliation is achieved by showing that the scope
of market discipline is wider than had been previously recognized. This same gap has been bridged in official corporate pronouncements, and in some academic analyses, by a theory of an evolving recognition of corporate social responsibility and trusteeship.\textsuperscript{44} Here, the market mechanism is conceded to be deficient, but its defects are remedied over time by a nonmarket system of managerial noblesse oblige, conscience, intelligent self-interest, and outside pressures. Other less sanguine liberal analysts have denounced the system of noblesse oblige both as inadequate and a public relations cover for business opposition to needed government intervention, and some of them have used managerialism to build a case for changes in corporate structure and rules of governance and positive government actions to bridge a widening gap between private power and the public interest.\textsuperscript{45}

For Marxists, and others on the left, managerialism posed the problem of how to reconcile management control with the class character of capitalism and capitalist control of the economic process. The concept of managers as "a purely neutral technocracy"\textsuperscript{46} suggested that a new leadership had emerged, separate from capital and the owning class, that might rise above class conflict and direct capitalism from a disinterested trustee perspective. This implication led to the vehement rejection of managerialism by many Marxists. For others reconciliation was achieved by a denial of the "neutral technocracy" idea and a focus on the ownership and other linkages that make the managerial elite merely "the leading echelon of the property owning class."\textsuperscript{47} In a sense, this is a rejection of separation rather than a reconciliation, as ownership interests still dominate a control group that represents ownership and controls only within a narrow range of profit-oriented choices. On this point there is a fusion of ideas between left and right, with Milton Friedman also contending that formal separation has not altered the fundamental orientation of management in the owners' interests.\textsuperscript{48}

Whereas some observers accepted managerialism and tried to work it into existing frameworks, others responded with attacks on its assumptions, facts, and inferences. Most of these attacks have had little effect on the institutionalization of the major managerial premise, but some have raised important questions about the meaning and significance of the managerial triumph. From the very first, the Berle and Means measures of the 200 largest nonfinancial corporations were subject to criticism. Their universe included regulated as well as unregulated firms — that is, firms
whose power was already circumscribed by government control, along with those not so controlled. The regulated sector (telephone companies, electric and gas utilities, railroads) is capital-intensive, so that an asset-based computation tends to exaggerate the importance of the controlled sector. The controlled sector also tends to be more concentrated as well as more limited in freedom of action, containing as it does a number of “natural monopolies.” In an early criticism of Berle and Means, William Leonard Crum pointed out that public utility, railroad, and traction companies accounted for five-eighths of the Berle and Means total; he also noted that, taking industrial assets alone, only 30 percent of the relevant assets were controlled by the 106 largest industrials, whereas 49 percent of nonfinancial assets were controlled by Berle and Means’s 200 largest. 49 Thus the biases inherent in the Berle and Means selection were questioned early and continue to be at issue.

Another continuing thread of criticism has revolved around the meaning and significance of any measure of “aggregate concentration,” a concept popularized by Berle and Means. The proportion of assets and net income controlled by the 200 largest nonfinancials is an index of overall, not market, concentration. Traditionally, the focus of economists has been on “market concentration,” and many have been dubious of aggregate concentration as a meaningful rubric of analysis. Rejection of the usefulness of aggregate concentration, and even market concentration, and counterfactual studies of trends in both overall and market concentration have been important features of the conservative response to Berle and Means. 50 Many things can be happening within a global aggregate, even a narrower aggregate, such as all manufacturing industry (which has been the basis for a number of studies of miniaggregate concentration trends). On the other hand, it is difficult to avoid the suspicion that an upward trend in the absolute, and especially the relative, importance of large units is devoid of economic or social significance.

An important left-oriented school of criticism, which has ebbed and flowed since 1932, has argued that managerial analyses have underestimated ownership and family control and overrated management control. This line of criticism was given powerful impetus by the Temporary National Economic Committee Monograph No. 29, The Distribution of Ownership in the 200 Largest Nonfinancial Corporations, prepared by the Securities and Exchange Commission (SEC) under the direction of Raymond W. Gold-
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smith and Rexford C. Parmelee, and published in 1940. This invaluable study is the only one ever produced in which Congress used its powers to gather extensive ownership data from a wide spectrum of large corporations. Based on fairly full information on the 20 largest holders of each of the 200 largest companies, with a detailed look behind record ownership to beneficial interests, and with a major effort to connect family and other interest group linkages, Monograph No. 29 found ownership and family control substantially more important than did Berle and Means. The latter found only 34 percent of the 200 largest to be subject to owner/family control. Monograph No. 29 showed 46 percent of the largest firms to be owner/family controlled, although many of these owners turned out to be other corporations. More recently, Philip H. Burch, Jr. effectively attacked the original Berle and Means data and came up with his own finding that owner and family control, although subject to a historical downtrend, is far more important than Berle and Means realized. Using a 450-firm sample, Burch found management control and family control at an approximate standoff in numbers—41 percent management, 42 percent family, 17 percent uncertain. Burch was not talking about the largest 200, however, and his own definitions and methods are not beyond criticism.

Another major basis of continuing criticism of managerial analyses has been an alleged neglect of the power of financial institutions as centralizing control vehicles. As Crum observed in 1934, “Full examination of the degree of concentration of economic power, would by all means cover the relation of financial institutions—incorporated or otherwise—to non-financial units.” In the Berle and Means study, financial control was obscured by their use of the category “control by means of a legal device” (a technique frequently employed by financial interests in the late 1920s), and they gave little attention to nonownership bases of financial control, such as creditor status. Monograph No. 29 also confined itself to ownership facts (including owner participation in management), noting that “no account, however, will be taken in this chapter of control by bankers or control of officers and directors if it is not also reflected in stock ownership.”

The concept of financial control, in fairly refined form, dates back at least to the Pujo Committee report (1913) of the Morgan–Baker era, Louis D. Brandeis’s Other People’s Money, and How the Bankers Use It (1914), Rudolf Hilferding’s Das Finanzkapital (1910), and Lenin’s Imperialism (1916). The 1939 National
Resources Committee study, *The Structure of the American Economy, Part I, Basic Characteristics*\(^5\) added 50 financial institutions to Berle and Means's 200 largest nonfinancial corporations and dealt at length with interlocking directorates and interest groups. Appendix 13 of the 1939 study described 13 interest group systems, several centering in investment and commercial banks. More recently, the Patman Report of 1968, entitled *Commercial Banks and Their Trust Activities: Emerging Influence on the American Economy*,\(^5\) gave further impetus to the stress on the importance of financial institutions in corporate control, showing the extensiveness of large holdings of corporate stock by bank trust departments.

**Corporate control: overview and prospectus**

Despite the persistence of these various lines of criticism of managerialism, its position has strengthened over time, and, at this juncture, its triumph is virtually complete. That top managers generally control large corporations is an established truth, which serves as a premise—not as something to be proved—in most serious analyses in the field of industrial organization and policy. Among the explanations for this triumph, the most important is surely that enhanced managerial discretion and power are a reality. There is, however, an ambiguity in the managerialist premise, which tells us that management controls, but leaves open the question of the determinants of and the limits to managerial authority. The premise is thus sufficiently elastic to accommodate a range of possibilities, extending from unrestricted management discretion to levels of constraint that raise questions about the extent and even the reality of management control. This vagueness traces back to the original Berle and Means formulation, which was very sketchy on managerial interests and, especially, on managerial power. Their managers either controlled or did not control; any gradations or limits were pretty much ignored. It was from this simple dichotomy that Berle and Means arrived at their notion that the controlling managers might eventually serve as neutral technocrats. Unrestricted management control was also implicit in James Burnham's fuzzy vision of a "managerial revolution."\(^5\)

Managerialism, however, is a broad concept in which these theories of managers as autonomous technocrats are only special cases. The managerialist perspective developed in this book, for example, which incorporates a number of internal and external constraints, finds managers to be a far cry from neutral technocrats.
The analysis here concludes, in fact, that the profit motive has suffered no discernible eclipse as a result of the rise of management control.

In developing this argument in the chapters that follow, I begin with a discussion of the concepts of control and strategic position and put forward a theory of control based on the importance of strategic position. I show how this theory fits in with the role of the board of directors as it has evolved in the United States (Chapter 2). This theory of control is amplified in Chapter 3, which describes the decline in ownership control and factors underlying that decline, but which treats at length the ways in which ownership persists as a powerful influence and constraint on managerial ends and behavior. This line of argument is supplemented with a discussion of the internal structural changes and rules of behavior that developed out of a search for order and rationality in these sprawling giants — arrangements that preserve and reinforce a profitability goal. Chapter 3 also provides a classification and description of the control status of the large corporation as it has evolved from 1900 to the mid-1970s.

Having developed a theory of constrained managerial control of the large corporation in Chapters 2 and 3, in the succeeding chapters I turn to a closer examination of sources of potential influence or control that are external to the firm — mainly financial institutions and government. Chapter 4 analyzes lender and institutional investor influence, describing in detail the reasons for the decline in financial control over the large firm during the past 70 to 80 years. Financial power is shown to be real, but exercised as a constraint and an ideological influence rather than by direct control over the large corporation. In Chapter 5, the role of the government is examined, as both a participant in the world of large firms and a regulator. The government’s position as a member of the universe of large firms is shown to be extremely modest. More surprising — and more controversial — its role as a regulator is found to be overrated, at least as regards scope and impact on business decision making. Large firms subject to extensive regulation by commission have declined in relative importance over the past half century (particularly, the railroads), with a resultant decline in the proportion of large firms directly regulated by government. The new social regulation has clearly expanded in scope and is often not trivial in effect, but in a number of areas the government agencies responsible for enforcement have been underfunded and ineffectual, and overall they are most properly regarded as providing a slowly expanding set of constraints on key
corporate decisions, which are still made with great freedom of maneuver.

In Chapter 6, I turn from the external threats to managerial autonomy (banks and governments) to the looser ties and bases of coordination among large firms and to the broader question of centralization of corporate control and power. I treat briefly the changes in aggregate concentration and large-firm market control — concluding that both have increased somewhat in recent decades over substantial levels in the past. The chapter examines mainly the various forms of ownership, business, and personal linkages among large firms, their changes over time, their strength, and the extent to which these ties are likely to affect the autonomy and behavior of large corporations. The primary conclusion from this inquiry — very tentative, given the great complexity of the subject — is that large firms in the United States are probably, on average, as independent of outside domination now as 80 years ago. Strong and tightly knit interest groups effective in integrating large firms have declined in importance, and although the large number of ties that are shown to link together large firms (including financial institutions) are a factor serving to mitigate competition, such ties are only one factor in a complex setting.

In the final chapter an attempt is made to apply the earlier analysis of corporate control, objectives, and power to contemporary problems and proposed avenues of change. I discuss in detail the prospects of change through voluntary managerial assumption of larger social responsibilities, through external pressures on corporations by interested individuals and community or public interest groups, and through improved disclosure and changes in the composition and duties of boards of directors. These are all shown to be extremely feeble mechanisms for bringing about change in the short run, with long-run effects that are highly uncertain. It is argued here that more significant change might follow from a turn toward public ownership (rather than regulation), which, by enlarging the role of government as a producer, would reduce business leverage. But the evolution of the corporate order in the United States and the structure of interests and power that it has produced have muted pressures for public ownership while furthering the drift toward centralization. The conclusion stresses the immobility of this corporate order in the face of escalating social and economic problems and presents some plausible scenarios for the next decade or so.
Control and Strategic Position

The basis of management control is strategic position, and the essence of a managerial theory of control must be an explanation of how strategic position conveys power, how management comes to command it, and why its importance has grown over time. By strategic position I mean a role and status in an organization — usually associated with high executive office, a directorship, and high official committee positions in the bureaucratic structure — that enable their possessors to participate in the making of key decisions. In the first part of this chapter I examine the concept of control and the problems of applying it to the large corporation. In the section that follows the focus is on how strategic position is attained, why it gravitates into the hands of an inside management group as concentrated entrepreneurial ownership positions gradually shrink, and why and how strategic position provides a basis of power and control. Attention is next directed to the board of directors — the immediate and legal locus of control — to see how this important institution fits into the control puzzle. A further section is devoted to an examination of the interplay between board and management power and the stability of corporate control when strategic position is its prime basis.

The concept of control

Control Versus Constraint

Control is a term used in many disciplines as well as in common parlance. It relates to power — the capacity to initiate, constrain, circumscribe, or terminate action, either directly or by influence exercised on those with immediate decision-making authority. The concept is elusive in the social sciences because power is elusive. In the giant corporation the number of actions over which power can be exercised is great and the number of potential influ-
ences on those actions is also very large. There is no one locus of power, and the power loci vary in importance by type of action.¹

Many decisions within a large organization are influenced, often decisively, by its own internally dictated set of drives, momenta, and constraints in some sort of dynamic equilibrium.² Bureaucratic organization and decentralization of decision making, if not extremely well controlled from the top, may also allow the emergence of subgoals within departments and divisions that protect and enlarge their interests at the expense of overall organization goals.³ What appear to be decisions by top officers and the board alone may be dictated by pressures from below, and the failure of corporate leaders to take some particular action may be based on a recognition of negative responses from within the organization that would have made otherwise sensible actions unfeasible.⁴

Similarly, external factors affect the making of important corporate decisions. Unions bargain on wages and working conditions, and their presence, strength, and negotiating position and terms can have profound effects on a variety of corporate decisions (including investment and divestment in particular locations).⁵ Various levels of government tax, subsidize, restrict, and control business, in some cases impinging directly on matters as basic as pricing (rate regulation, informal interventions into price setting) and the direction of investment (zoning, required pollution control devices, limits on acquisitions). Community pressures arising out of the interests of parents, environmentalists, and other consumer and public interest organizations, affect business directly and through induced or threatened governmental actions. The large corporation also interacts extensively with other business firms that lend it money, sell its securities, buy its goods, supply it with raw materials, and join with it or its officials in political and social activities. External corporate interests predominate as outside representatives on boards of directors. They are "coopted" to some degree by the relationship, but obtain power in exchange. The discretion of the insiders of a corporation is constrained to a greater or lesser degree by these external interests that are linked with the organization.⁶

The assumption made here is that the more remote and relatively fixed background constraints can be reasonably ignored in trying to identify the control of a large corporation. That is, the corporation and its control can be analyzed in a useful first approximation as a "closed system."⁷ This still leaves open serious problems concerning the weight to be given potential decision
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makers and constraining elements that are not very remote, such as the managers of subdivisions within the larger entity or bankers lending money under restrictive covenants and serving on the board or large owners hovering in the background.

In these large complex organizations the highest echelon of leaders frequently farms out to its various operating units considerable administrative and operational discretion. But the top management almost always retains and normally exercises final authority over long-term strategic planning; capital allocations among various corporate activities; major geographic and product moves; and decisions on top personnel hirings, firings, and promotions. In a great many cases the installation of a new top management is followed by substantial changes—firings, functional and divisional realignments, lopping off of divisions and subsidiaries, undertaking new domestic and overseas ventures, a policy of systematic acquisitions. In short, whatever the constraints on the corporate leadership by outsiders and the internal interest groups within the organization itself, the leadership can usually make significant moves that will affect internal discipline, morale, objectives, and material direction and well-being.

A distinction will be made in this study between literal control and the exercise of a constraining influence, although the line between the two is narrow and somewhat arbitrary. Literal control as used here means the power to make the key decisions of a company, which include choices of products, major markets, volume and direction of investment, larger commercial and political strategies, and selection of top personnel. The power to constrain is used to mean the power to limit certain decision choices, as in a ceiling on dollars that may be spent on new facilities or paid out in dividends, or a power of veto over personnel choices. The two terms are not mutually exclusive as defined here. A constraint is a form of control even if only negative in exercise, as it shapes the decisions made by limiting the scope of choice. In many cases the power of veto is accompanied by the power to consult and a positive say in what is to be done. A constraint also merges into control when it extends to the power to displace the active management. But constraints usually involve power over only one or a narrow range of corporate activities, so that they amount to partial control rather than control over the entire spectrum of major decisions. The frequent pattern in the large corporation is for power over a wide range of decisions to be held by a dominant insider coalition, subject to constraints or partial control by others in
some decision areas (e.g., bankers in regard to volume of borrowing and perhaps investment).

There are also important constraints on managers that arise out of the profit, risk-taking, and growth expectations of the board members, large owners, financial community, and working members of the organization itself—expectations that may be formalized into rules and plans, and internalized in managerial objectives and understandings. It may be argued that if the system of constraints forces managers to choose policies within a narrow range of profit opportunities compatible with stockholders or creditor interests, the constraints may be as, or more, important than the specific discretionary choices of managers in determining corporate objectives and actions. If these constraints grow, the discretion of control groups could actually shrink over time. It is one of the main themes of this book that the managerial revolution has been one of increasing, but sharply constrained, management control, with the controlling managers operating within behavior boundaries that have not widened over time.

Active Versus Latent Power

Closely paralleling the distinction between control and constraint is that between active and latent power. With control by owner/ managers (Ford Motor Company before 1979) or by a nonowner management (American Telephone and Telegraph Company) active power and control are merged; but where some power is still held by large owners who are no longer part of the working management, or by financial interests that promoted the company, the extent of decision-making power retained by the nonmanagement groups becomes harder to assess. It is possible that they still make the decisions directly or select the top managers and then instruct them and monitor their actions closely, but more often their power is less directly maintained; they recede farther into the background, sometimes only to intervene when something goes seriously astray. Their power is then latent, but it may still be effective as a constraint. There are many stages between the extremes of active direction from behind the scenes and withdrawal into a latent and constraining role. The exact state of affairs is often hard to determine, as it may not be put to the test over a long period during which the power structure is evolving in sometimes subtle ways. The problematic cases are frequently those of declining family/owner power, where the family’s stock-
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holdings and influence on the board are dwindling and the strength of the active top insiders is growing. The residual, latent power of the family/owner may depend on circumstances, and even in times of transition is sometimes elusive.

In the case of Allied Chemical, for example, the Solvay group of Belgium has had a large minority interest for many years (20.3 percent in 1937, 9.7 percent in 1979), but it has usually had only one indirect representative on the board, and no overt control, despite both this large holding and the absence of any comparably large minority blocks in other hands. Nevertheless, in 1967, after a period of declining earnings, Jacques Solvay requested and obtained a seat on the board, and shortly thereafter a new top management group was installed with John Connor brought in as chief executive officer (CEO).

This would appear to be impressive evidence of Solvay latent power and ability to control, but the impression would be somewhat misleading. The management displacement occurred at a time of serious company malaise, so that the latent power exercised then might not have been decisive under different company circumstances. And Solvay did not act alone in the 1967 turnover; other powerful forces were at work. In fact, the Meyer and Nichols family interests were long predominant in the power alignments of Allied Chemical,9 despite smaller stockholdings than Solvay, and both were still directly represented on the Allied Chemical board in 1967. Their power came from early strategic position, personal—as opposed to Solvay’s represented—presence on the board, and some Solvay reticence based on antitrust and foreign status complications.

The business success of Allied Chemical under Connor, between 1967 and 1978, almost surely reduced the latent power of the Solvay interests relative to the inside management group and strong board. An interesting aside on the Solvay role was the 1977 contingent agreement by Solvay to sell its entire holding in Allied Chemical to Textron, represented on the Allied Chemical board at that time by G. William Miller, then CEO of Textron. The reason for this offer was reportedly to provide funds for a contemplated expansion of Solvay facilities in the United States. Despite joint ventures and other business relationships with Allied, plus its formidable holding of Allied stock, it is evident that Solvay did not regard Allied Chemical as a controlled arm capable of meeting Solvay’s needs in the United States.

In the case of S. S. Kresge, as another example, the Kresge fam-
ily owned 37 percent of the company's stock in 1964 and occupied several top managerial posts. In 1975 only Stanley Kresge, a non-officer, remained on the board of 17 as a family representative, and his personal holdings amounted to only 855,672 shares (0.7 percent of an outstanding total of 120,238,158). The Kresge Foundation, probably still under Kresge control, had almost 10 million shares in early 1975, so that the Kresge family was still in a position to vote at least 9.7 percent of the company's stock. S. S. Kresge had grown into a major retail force only since 1962, under the direction of very successful hired managers. The enormous expansion of Kresge greatly increased the stock outstanding and reduced the relative holdings of the Kresges. The success of these hired managers tended to consolidate their power over the corporation. In a symbolic episode occurring at the 1977 annual meeting of S. S. Kresge, the management proposed and won a vote for changing the company's name from S. S. Kresge to K Mart. This move was commented upon at the meeting by Stanley Kresge, speaking from the floor as a now retired director. He was not happy with the change but would not oppose it.

Latent power may also rest with banks and other institutional investors, based on stockholdings, credit extensions, loan agreements, indentures, influence over the availability of future credit, and so forth. The power of these important outsiders is likely to depend not only on past business and personal connections but also on the magnitude of capital demands imposed by technology, marketing costs, growth plans, and growth rate of the company and industry. The financial well-being of the company in question has always been another critical factor, with external power increasing as the company approaches credit limits and violations of loan agreement terms. As noted earlier, lender power is often negative in character, derived in part from lender rights under credit agreements, in part from management's unwillingness to proceed on programs looked upon with disfavor by institutions whose goodwill is important. This veto power usually applies only to certain spheres of company activity (forms and quantity of borrowing, dividend payout rates, sale of underlying assets), although there is great variation running from negligible creditor power to the power to displace the active management. For very large corporations, creditor and other institutional investor power is usually latent rather than active, part of a system of constraints, and, at the same time, part of a system of interlocking power that
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is more often supportive than threatening to dominant management groups.

Shareholders in general can be said to have some sort of latent power over large corporations, but the diffusion of ownership is such that ordinary stockholders do not directly threaten management displacement. Important differences among owners in wealth, tax factors, investment objectives, attitudes toward dividend payout rates, and desired degree of risk in investment undertakings further weaken the power of ordinary investors. Their latent power, therefore, constitutes a background constraint that is of concern to the control group in that disenchanted owners will contribute to depressed stock prices, will welcome tender offers, and may possibly harass the management in other ways. The potential for loss of control through tender offers and public relations concerns have increased management sensitivities to the latent threat of ordinary shareholders.

The board of directors “controls” the corporation in a formal legal sense, because the bylaws give it the power to make key decisions by majority vote. But, as discussed more fully later in this chapter, top inside managers normally dominate the board selection and decision-making processes and the board and outside directors are best viewed as having various degrees of latent power. Outsiders on the board normally defer to and support the top inside managers, but they do have legal responsibilities to the company’s owners and often represent outside interests of great power. Under some circumstances, therefore, top management nonperformance, malfeasance, or disarray activates the outsiders and induces them to exercise their legal powers.

Those possessing latent power share it with those who have active power, which is exercisable within limits, under constraints, and on a contingent basis. Shared power is the general case in complex organizations, because a wide spectrum of interest groups invariably impinge on the decision-making process. In a sense, therefore, “a complex decision is like a great river, drawing from its many tributaries the innumerable component premises of which it is constituted.” Its “tributaries” include owner and creditor expectations and rights, government rules, and organizational pressures and imperatives. Nonetheless, virtually all the major corporate decisions are shared in or finally decided upon by a small group of high-level leaders of the organization, whereas outsiders with influence usually exercise it in a much narrower sphere.
The Mechanisms Versus the Locus of Control

There are two related but different aspects of control: how control is maintained (the mechanics or instruments of control)\textsuperscript{13} and who controls (i.e., the distribution of power between owners, managers, banks, etc.). Ownership is often both a mechanism of control and the locus of control; but in the numerous and important cases where minority ownership concentrations run from 1 to 15 percent, the overlapping of how and who becomes less assured. As a mechanism whereby control is achieved and maintained, a 5 to 6 percent holding may or may not be relevant, depending on circumstances. Somebody may own 6 percent of a company’s voting shares and have no power whatsoever in its affairs, as in the case of Richard Gruner’s purchase of 5.6 percent of the voting shares of American Airlines in the early 1970s or of a great many holdings of comparable size by institutional investors. If, on the other hand, a control group holds 6 percent of the stock of a company but would easily control by strategic position with no stock ownership whatsoever, the 6 percent holding is not the \textit{means} of control. Of course, one of the claims for the significance of the rise of managerial control is that the control groups tend to have no important ownership stake in their companies and 6 percent of the stock is a substantial interest in absolute terms, even if proportionately small (and possibly irrelevant as a mechanism of control). In large companies even small fractions of stock are quite important in magnitude of dollar investment – Armand Hammer, with only 1.8 percent of the stock of Occidental Petroleum and John Kendall with 2.8 percent of Colgate-Palmolive had investments valued at $13 million and $44.3 million, respectively, at the low market levels of December 1974. It is possible to have a large stake without that stake being especially important in explaining how control was established and how it is maintained.

The failure to separate how control is maintained and who controls has probably led to an overrating of ownership as a mechanism of control, but it may well have caused an undervaluation of the importance of the ownership stake of control groups and of ownership as a constraint factor.

It is a fallacy, sometimes put forward by those anxious to establish the continued importance of ownership as a vehicle of control, that the diffusion of ownership eventually makes possible the control of large corporations with very small stockholdings, say, 1 to 5 percent. This represents a confusion between who controls and
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how control is obtained and maintained. There is no case known to this author where the acquisition of 1 to 5 percent of the stock of a large corporation by an outsider gave the purchaser control; from this I infer that without initial strategic position, 1 to 5 percent has little bearing on control. It also suggests that if persons who do control have 1 to 5 percent, it is not the stock that is critical to their control position; at best it strengthens strategic position.

The identification of control groups, that is, cases where separate blocks of stock should be considered to be unified from the standpoint of their impact on control, also presents problems. In a sense, all owners of a given company have a unified interest—which may be even more valid and pertinent for all small holders of common stock— but the small, absolute and relative size of their holdings, their impersonal and distant relationship to the organization, and the high cost of obtaining detailed knowledge about a company and communication among numerous stockholders normally limit the cohesion and power of ordinary owners. At the other extreme is a set of owners such as the five individual directors of Weyerhaeuser who each controlled 500,000 or more shares in the late 1970s (although with holdings still totaling only a little over 5 percent of the outstanding). These investors are knowledgeable, in close communication with one another, and interested in corporate affairs because of the size of their holdings and their active involvement. There is, therefore, a potential unity among this group, although it is obvious that there also could be conflict. But a primary basis of unification for the formation of meaningful control groups is organizational role and shared power.

Contemporary debate over the existence of group power commonly focuses on large owners with both substantial interests and the capacity to communicate with one another, but with no apparent organizational role, a frequent large number and diversity of such interests, and relationships with both other owners and the managements of the companies owned. The large institutional investors are the most important of such owners. Do ten bank trust departments, five insurance companies, and five mutual funds, together owning 35 percent of the stock of a large corporation, constitute a “group” from the standpoint of cohesiveness bearing on control? Two criteria are used in this study: (1) Do these institutions use their voting powers, directly or by threat, in a collective manner, designed to influence the selection of boards
of directors? (2) Does their use or threat of use of the power to buy and sell stock on a collective basis (whether tacit or explicit) allow them to exercise a decisive or substantial influence over corporate decision making? The answer to the first question, on voting power, is a clear negative; the answer to the second is that groups of owning institutions rarely work together to discipline managements, but they do think alike and emulate one another and their behavior does exercise a real influence. But this form of influence is more accurately described as a form of constraint than control.

Strategic position as the basis of control

In cases where companies are closely held or subject to majority ownership control, the dominant owners occupy the top offices themselves, or they select (and can readily displace) those who do — with the result that strategic position, in the form of occupancy of high office, is not a significant source of independent power. But with diffused ownership in large companies, occupancy of the top positions becomes an independent source of power that can be built up by deliberate strategies and passed on to successors. As noted earlier, strategic position as a basis of power is at the heart of managerialist theories; how strategic positions are attained and the reasons for their importance as a power base are considered in the balance of this section.

Strategic position typically has been attained by one of the following routes: (1) initial possession of a large stock ownership position or a major stock acquisition; (2) a role in organization and promotion (sometimes associated with the acquisition of significant stockholdings); (3) management changes or more far-reaching reorganizations following serious financial difficulties; and (4) the gradual accretion of power from within the organization.

The numerous railroad and other business failures in the depression of the 1890s and the combination movement around the turn of the century and in the 1920s greatly increased the importance and strategic position of promoters and bankers. But these original positions of power eroded fairly rapidly as hired managers struggled for, and obtained, substantial autonomy for the organization and its active management. Because the largest corporations normally have not been dependent on individual commercial and investment banks for corporate necessities, the preservation
of control positions by promoters or bankers would have had to rest on an aggressive monopolization of high office by themselves or through reliable dependents. But the domination of high office by bankers is not conducive to business efficiency, and "reliable" dependents may cease to be so in a newly established organization where their functional interests diverge from those of outsiders. Furthermore, in contrast with Germany and Japan, banker control has always been suspect in the United States and subject to periodic waves of adverse publicity and government-imposed limits that have made the preservation of strategic position by bankers more difficult; the appearance of autonomy has been obligatory, and without any permanent basis of real control; this has contributed to the emergence of genuine autonomy.

Although more durable than banker control, direct ownership control has also tended to decline, partly because of an attrition of entrepreneurial stock positions under conditions of rapid growth, and also because entrepreneurial skill often does not extend to the second and third generation (or, even if it does, is unlikely to be the best obtainable) and strategic position is relinquished in the interest of higher profits through more effective management. In the Kresge case, for example, it was the hired managers that brought the firm from modest affluence to preeminence in prestige and profits. Thus top-level positions are gradually occupied by hired managers, even in cases of dominant (if declining) ownership. Over time, and with corporate success and substantial growth, significant power gravitates into the hands of the hired managers. The normal, but not uniform, trend is for the "hired managers" eventually to be hiring themselves, at which point cooptation rather than hiring becomes the relevant concept.

Ownership has been and remains an important basis for obtaining strategic position; it has a solidity as a power base beyond that available to the promoter and banker, assuming retention of a large proportionate interest. Stock-based power and strategic position reinforce each other. But with the rapid growth in corporate size, the sales of new issues in the public market, and the divestment of stock by the former dominant owners, the retention of control by the former owner group will depend increasingly on the power derived from strategic position – occupational role and status – rather than on ownership.

In the case of Federated Department Stores, for example, the relatively large Lazarus family holdings had fallen to 0.8 percent
of the outstanding by 1980, but there was little question that Ralph Lazarus was the key decision maker and final authority. His power, which had arisen out of significant family ownership plus occupancy of many key positions, now rested almost entirely on strategic position. Somebody from the outside buying 384,375 shares (0.8 percent) of Federated might be able to get a representative on the board of directors but certainly would not be able to gain control. It was recognized in the organization that Ralph Lazarus’s retirement would rapidly transform Federated from the last stages of family control to one more case of management control. This would not be so if the Lazarus stock ownership rather than the family’s strategic position were critical to control.

The strategic position and power of the management (the top full-time officers of the organization, some of whom are usually on the board of directors) stem in large part from its authority and dominance over day-to-day operations, the disposition of company resources, and the planning and long-term decisions of the company. The top officers and their employee subordinates devote full time to doing the business of the company, assessing its problems and prospects, and making and implementing plans for its improvement. By virtue of this concentrated effort and presence, they have special command over the technical details essential to an intelligent consideration of company problems. They also must of necessity make a great many immediate decisions that require experience, knowledge, and on-the-spot presence. Most of the specific decisions involved in day-to-day operations are made by middle managers, but those at the top call the tune, set the parameters within which choices are made, and make some of the important specific decisions (including the compensation, promotion, and ouster of those below them in the managerial hierarchy). These are the built-in advantages of top management that give it a structure of dependencies both within the organization and outside (customers and suppliers), and thus give it power. This power extends to the board selection process and board decisionmaking (described more fully in the next section). Domination of the board and proxy machinery of the corporation is the link between the de facto power of the managerial leadership and the legal but nominal power of the diffused ownership.

If the company is doing well, employee morale is high, and the various cogs in the large machine are geared together in working order, then the power of the management is further enhanced,
because interference with or displacement of the top management would involve a serious loss of efficiency and profits. Interests potentially capable of ousting a management, such as large stockholders and lenders, would find it difficult to convince others of the need to replace management under such circumstances and would be threatening their own economic interests by disturbing a favorable set of arrangements. Business success, therefore, enlarges managerial freedom of action.

Conversely, economic difficulties weaken the position of management by increasing the dissatisfaction of and reducing the costs of displacement by groups and individuals with latent power in the organization. Even in this case, however, managerial control over the flow of information to outside directors and outside financial interests, its influence over board members derived from personal or business relationships, and fears of disruption and open conflict frequently allow managerial survival and continued domination of the succession process under conditions of proven managerial ineptitude.

An important underpinning of any theory of control and its evolution must be the recognition that control is valuable and will be sought and consolidated by those capable of gaining and preserving it. As noted, an exception is that control may be relinquished by entrepreneurial families as a result of a quest for higher profits through superior management. Banker/promoters tend to suffer displacement because of managerial advantages in strategic position and an absence of compelling banker leverage or interest. The top management seeks to enlarge its control in the interest of unobstructed ability to carry out its plans, job security, and other personal and psychological advantages of uncontested power. An obvious threat to secure management control would be a truly independent and strong board of directors. Rational behavior by an inside management group, desirous of maintaining control, therefore, should be to see to it that the complexion of the board becomes friendly and compliant. This is not always possible, or even thought necessary by self-confident insiders, but the mechanisms and traditions of board selection processes and practices make a compliant and management-supportive board a dominant tendency in the large corporation of the United States.

I turn now to the question of the role of the board and show how its legal control of corporate policy is reconcilable with de facto dominance by corporate insiders.
The board of directors
Because the legal power to control corporate affairs rests with the board of directors (and ultimately the stockholders), analysis of the dynamics of the board must be a linchpin of any analysis of corporate control. This is especially true in an era of apparently dwindling ownership power, when definitive ownership command over a majority of the board is usually absent and the locus of power is subject to a potentially more complicated set of determinants. The subject is especially important because a great many reform proposals rest on theories of board control and adaptability that may not be realistic.

The role of the board need not be static or uniform, of course, and changes in ownership dispersion and power, in corporate size and diversity, and in the external problems faced by the corporation might plausibly be expected to produce both a change in board character and function and considerable variety among boards. The past decade has seen turmoil in many boardrooms, with scandals that have resulted in adverse publicity, lawsuits and enhanced threat of legal liability for board laxity, pressures for broadening board representation, and antitrust challenges to interlocking directorates. Many commentators claim that these new challenges have already produced major changes and that a boardroom revolution is well under way, with formerly supine directors being replaced by independent, questioning, active individuals. It will be argued subsequently that no boardroom "revolution," actual or incipient, has shown itself or is likely to emerge under present institutional arrangements. A good deal of the emphasis and fervor on board changes arises from an over dramatization of marginal shifts of limited impact, as well as from the fact that much writing on the subject is exhortative, tending to confuse what ought to be with what is and what is likely to be.

Corporate boards exist, in part, to meet the legal requirement of chartering authorities that a board of directors of three or more individuals be constituted who will run the affairs of an incorporated organization. All boards, even those of corporations solely owned by a single individual, must meet this chartering requirement. Because the board is legally responsible for running the corporation, the problem of nominal versus real power is immediately apparent. And it is just as quickly evident that if the Ford Motor Company of 1929 had three directors, including Henry Ford, it would not be sensible to say that all three directors equally
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dominated the corporation. All the directors would be on the board by grace of Mr. Ford. It is equally well understood, even in corporations where the control group has a minimal stock interest, that outsiders "invited" onto a board are not the power equals of the more permanent top cadres of management. The frequent use of the word "invited" suggests a guestlike and transitory status of the outsider, and because the invitation is very often from top management, board criticism of the corporate leadership violates the laws of hospitality. As observed in a 1975 Conference Board study, "many directors feel a sense of loyalty to the chief executive because they serve on the board at his request, and may even have close personal ties." Criticism also may conflict with business considerations and other forms of reciprocity, as a great many directorships involve director interchanges or business interconnections, discussed in detail later. The transitory status of outside directors may be reinforced by implicit or even explicit agreements that the directorship is terminable at the discretion of the top insider or insiders.

The roles of boards of large companies vary according to the industry and its traditions, the condition and prosperity of the firm, other special circumstances, and the choices of its top management. But it is widely agreed among sophisticated observers of boards that, in the main:

1. Outside directors are not invited to join the boards of major corporations to "run" the firms or to decide on basic policy.
2. Outside directors are usually passive and do what managements want them to do.
3. Managements want boards to carry out certain limited functions, principally advising in areas of competence, solidifying relationships with important external constituencies, assuring the outside world by their presence that the organization is in good hands, and providing a standby facility for emergency use in times of crisis.

Important exceptions to this restricted role can be found where large stockholder interests are still represented on the board or where financial or managerial crises have compelled board activation. More broadly speaking, the board serves as the locus of some of the forces that influence managerial ideology and constraint
management power. Nevertheless, the great majority of outside directors of large managerial companies play a limited, dependent, and passive role that has remained essentially unchanged during the course of the twentieth century. In 1905 Jacob Schiff told the Armstrong Committee that, as an outside director:

I directed as much as under the prevailing usages in corporations was permitted me to direct; in other words, I went to the meetings . . . listened to the reports . . . and gave such advice as was asked of me . . . and if under the prevailing system an executive officer wishes to do wrong or wishes to conceal anything from his directors or commit irregularities such as have been disclosed here, the director is entirely powerless . . . and can only judge of such things as are submitted to him.²⁸

Seventy years later Jeremy Bacon and James K. Brown wrote in a Conference Board study that "Unless the chief executive officer wants his directors to become actively involved, it is all but impossible for them to become very effective."²⁹

Despite the cyclical return of cries for "direct," and the claims of lessons learned by the now wiser outside directors, little has happened in the past dozen years to alter the distribution of power or the structure of control of large corporations in the United States. There have been changes in board composition and committee structures, most notably an increase in the relative importance of outside directors and a sharp rise in the use of outsider-dominated audit committees. There has also been an increase in potential liability for carelessness, imprudence, or mere inactivity of board members, more outside pressures on boards and, in recent years, "signs of greater independence and initiative by corporate boards."³⁰ But offsetting these developments has been the greater complexity of large companies and the enlarged information gap between outside directors and inside management. Stanley Vance has noted that:

In every recent headlining boardroom scandal, beginning with the classic Texas Gulf Sulphur Company case, there was a preponderance of outsiders on the board at the time of the scandal. For example, the inside/outside balance was 2 to 10 at Texas Gulf, 5 to 12 at Lockheed, 4 to 18 at Penn Central, 3 to 6 at Northrop and 3 to 9 at Gulf Oil. Even at W. T. Grant and Company, where the embarrassment was bankruptcy rather than illegal action, outsiders outnumbered insiders 11 to 6. With scarcely an exception, almost 200 corporations, having confessed to recent illegal domestic political
campaign contributions or to payment of bribes abroad, have all had outsider-dominated boards.\textsuperscript{31}

Inside management's incentive to obtain and consolidate control is obviously unchanged by recent developments. Furthermore, the board selection process was traditionally, and still is, dominated by the inside managers in the vast majority of management-controlled firms. E. Everett Smith concluded from his studies in 1958 that "For all practical purposes the board is a creature of the chief executive."\textsuperscript{32} A major Conference Board study made the same point in 1975: "It is clear from discussions with directors and chief executives alike that, by and large, the chief executive controls who will come onto the board while he is in power."\textsuperscript{33} This is one of the comforts of the CEO position, as Ernest Breach observed when considering whether to move from CEO at Bendix to Number Two Man at Ford: "I liked my job at Bendix. I named my own board of directors. I was having a good time."\textsuperscript{34} In many cases the majority of new board nominees and proposed officer realignments are initially put forward by the management itself. In other cases the outside directors are allowed, or even encouraged, to submit names of proposed new directors, but the top management usually retains the power to accept or reject such nominees. The insiders will usually want to meet with and talk to any new directors as well as to make a close study of their backgrounds and qualifications. It is a widely held view by students of the corporate board, including those in favor of substantial board reform, that divisiveness, factionalism, and serious conflict are not desirable board characteristics.\textsuperscript{35} For this reason, as well as because of the powerful position of the top management vis-à-vis outside directors, inside recommendations are (in the words of Courtney C. Brown) "seldom contested," and the imposition of new directors unacceptable to the top officers is "usually unthinkable."\textsuperscript{36}

Increasing numbers of sizable corporations have nominating committees that bring prospective nominee names to the board for its consideration. In the early 1970s the nomination process in most large companies was handled directly by management and the board; a 1973 Conference Board study found only 58 out of some 853 companies (under 7 percent) with official nominating committees.\textsuperscript{37} By the late 1970s, however, the proportion of large companies with nominating committees had increased markedly: to 23 percent in a Conference Board sample, 37 percent of a Korn/Ferry sample, and an even higher percentage according to other estimates.\textsuperscript{38} In a number of cases, board nominating committees
are comprised of outside directors only, and in others, the outsiders constitute a majority. But this is hardly indicative of a loss of nominee control by the inside management. The nominating committee will be a known and responsible group, and a tacit acceptance of the convention of management input and of ultimate clearance is an almost invariable part of the committee framework. General Motors Corporation (GM), for example, has a board-nominating committee composed entirely of outside directors but that committee's list preparation and review process is carried out in close coordination with the inside management.\textsuperscript{39} The selection of the Reverend Leon Sullivan to the GM board in 1971 followed a very intensive management/board investigation and discussion of GM strategies, as well as discussions between top GM management and Sullivan himself, after which “G. M. Chairman, James Roche, personally made a trip to Philadelphia to offer him the job.”\textsuperscript{40} An outside-director nominating committee is not a serious obstacle to inside domination of the board selection process.

Also bearing on the role of the board in corporate control is the size of boards of directors. Large boards make for weak boards.\textsuperscript{41} A large board is incompatible with the depth of discussion, the extensive participation of individual board members, and the kind of interaction and division of labor characteristic of so-called “working boards.”\textsuperscript{42} Large size also makes for diversity and fragmentation, which reduce the likelihood of a board threat to management domination. Board size is directly related to company size, particularly in manufacturing. Thus in the 1973 Conference Board survey the median-sized manufacturing company board was 11, but the median board size for the 83 companies with assets over $1 billion was 15.\textsuperscript{43} Table 2.1 shows that in 1975 the median-sized board among the 100 largest industrial companies was 14 and that 44 of these companies had boards with 15 or more members. A Conference Board survey of 1976 shows median board sizes for large companies as follows: manufacturing, 13; retail merchandising, 5; transportation, 15; utilities, 13; and bank holding companies, 22. Banks and, to a slightly lesser extent, insurance companies, usually have very large boards, whose roles appear principally to be strengthening customer relationships and enhancing institutional prestige. In 1975 the median number of directors for the 50 largest financial corporations was 21.5 (versus 14 for the largest industrials), and 13 of the 50 (26 percent) had 25
Control and Strategic Position

Table 2.1. Size of board of directors of the 100 largest industrials, 1975

<table>
<thead>
<tr>
<th>Size of board</th>
<th>Number and percentage of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 10</td>
<td>3</td>
</tr>
<tr>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>11</td>
<td>9</td>
</tr>
<tr>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>14</td>
<td>11 Median = 14</td>
</tr>
<tr>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>16</td>
<td>6</td>
</tr>
<tr>
<td>17</td>
<td>11</td>
</tr>
<tr>
<td>18</td>
<td>5</td>
</tr>
<tr>
<td>Over 18</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Compiled from proxy statements for spring 1975.

or more directors. The substantive functions of these large boards of financial corporations do not impinge on managerial control; the same may be said of the larger boards (15 or more members) in other sectors.

Those who feel that there is promise in board reform usually focus on the outside directors as the vehicle for discipline, monitoring, and, if necessary, displacement of operating management. If insiders are numerically predominant, however, or even comprise a very strong minority, outside directors may be able to do little of substance, even if they are truly independent. In the Conference Board surveys the proportion of manufacturing companies with a majority of outside directors has risen steadily over the years, from 50 percent in 1938, to 61 percent in 1961, to 71 percent in 1972, to 83 percent in 1976. But this still leaves room for a great many insiders on the board. The median percentage of insiders on boards of large manufacturing companies in the 1973 Conference Board survey was 39.5 percent, down moderately from 1961. In 1975 almost a third of the 100 largest industrials had a full majority of insiders on their boards, and over two thirds of the 100 largest had boards on which insiders comprised 34 percent or more of the total number of directors (see Table 2.2). The median
Corporate Control, Corporate Power

Table 2.2. Insiders as a percentage of total directors of boards of the 100 largest industrial corporations, 1975

<table>
<thead>
<tr>
<th>Percentage of insider to total board members</th>
<th>Number and percentage of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>75.0+</td>
<td>7</td>
</tr>
<tr>
<td>51.0–74.9</td>
<td>24</td>
</tr>
<tr>
<td>50.0–50.9</td>
<td>4</td>
</tr>
<tr>
<td>34.0–49.9</td>
<td>33 Median = 40 percent</td>
</tr>
<tr>
<td>25.0–33.9</td>
<td>24</td>
</tr>
<tr>
<td>10.0–24.9</td>
<td>8</td>
</tr>
<tr>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

*Includes narrow insiders only, defined as employees of the company or one of its subsidiaries, earning $40,000 or more per year.

Source: Compiled from proxy statements for spring 1975.

Table 2.3. Percentage of inside directors among 200 largest nonfinancial corporations, 1975

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Number of corporations</th>
<th>Relative frequency (%)</th>
<th>Cumulative frequency (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 10.0</td>
<td>3</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>10.0–24.9</td>
<td>43</td>
<td>21.5</td>
<td>23.0</td>
</tr>
<tr>
<td>25.0–33.9</td>
<td>55</td>
<td>27.5</td>
<td>50.5</td>
</tr>
<tr>
<td>34.0–49.9</td>
<td>46</td>
<td>23.0</td>
<td>73.5</td>
</tr>
<tr>
<td>50.0–50.9</td>
<td>14</td>
<td>7.0</td>
<td>80.5</td>
</tr>
<tr>
<td>51.0–74.9</td>
<td>32</td>
<td>16.0</td>
<td>96.5</td>
</tr>
<tr>
<td>75.0+</td>
<td>7</td>
<td>3.5</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>200</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

The percentage of insiders on these boards was 40 percent. Table 2.3 shows that for the 200 largest nonfinancials in 1975 the median proportion of insiders was one third and that half the companies had boards on which inside directors accounted for over one third of the total number of directors. Korn/Ferry's 1979 survey of large company boards shows that the average proportion of insiders was still almost one third. Table 2.4 shows the sharply different picture for the 50 largest financials, where for three quarters of the companies the insiders comprised under a quarter of the board.
Control and Strategic Position

Table 2.4. Percentage of inside directors among 50 largest financial companies, 1975

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Number of companies</th>
<th>Relative frequency (%)</th>
<th>Cumulative frequency (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 10.0</td>
<td>5</td>
<td>10.0</td>
<td>10.0</td>
</tr>
<tr>
<td>10.0-24.9</td>
<td>33</td>
<td>66.0</td>
<td>76.0</td>
</tr>
<tr>
<td>25-33.9</td>
<td>6</td>
<td>12.0</td>
<td>88.0</td>
</tr>
<tr>
<td>34.0-49.9</td>
<td>4</td>
<td>8.0</td>
<td>96.0</td>
</tr>
<tr>
<td>50.0-50.9</td>
<td>1</td>
<td>2.0</td>
<td>98.0</td>
</tr>
<tr>
<td>75.0+</td>
<td>1</td>
<td>2.0</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>50</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Because inside directors normally vote as a solid, unified block under the direction of top management, their sheer numbers make them a formidable factor in establishing management predominance in board affairs. Their power is greatly strengthened by the fact that insiders, working full time on corporate affairs, have a depth of knowledge of the organization, its technology, and business problems that outside directors are not in a position to challenge.

The power of the outside directors depends on a variety of factors — including, among others, their relative number, homogeneity, knowledge, power base in relation to the corporation, and relations with the insiders. Large owners and creditors who serve as outside directors on boards clearly have the most significant independent power base and potential weight. For the most part, however, outside directors do not have substantial power in the corporation and a large proportion of them (including creditors) have some sort of dependency on or reciprocity linkage to the corporation and its active management. The nature of the relationship between inside and outside directors is clearly important in assessing the locus of power in the board. Just how “outside” are “outside directors” and how “independent” are they from the top insiders? If top managers can successfully propose new directors and retain de facto veto power over proposed selections from outside directors, the board should gradually assume a character satisfactory (and subordinate) to the management. A friendly, helpful but definitely unthreatening, and perhaps really compliant and passive, board may be the norm.
Such a possible outcome raises questions about the outside directors' capacity to deal with top managers, at arms length, as fiduciaries of the owners.\textsuperscript{47} This issue has been addressed with increasing frequency in recent years; the New York Stock Exchange itself, for example, in its new listing requirement of 1978, calls for “an Audit Committee comprised solely of directors independent of management” and directs specific attention to a number of possible linkages that might compromise such independence.\textsuperscript{48} Given the board selection processes, we would expect a great many outside directors to have links to insiders as potent as nominal insiders. An examination of outside directors from this perspective shows an impressive array of linkages that suggest limited “outsideness.”

The bases of director selection that may involve significant connections with top management can be classified as follows: (1) former insiders, now retired; (2) relatives and personal friends of insiders; (3) those deriving economic benefits from the existing control group, or having other important business relationships with its members; and (4) those whose institutional roles and dependency on the business community promise limited or minimal demands on the control group.

Table 2.5 classifies directors of the 100 largest industrials in 1975 according to degrees of “outsideness,” based on information assembled from a wide variety of sources, but mainly on company proxy statements and directories showing further affiliations of individuals. In 1975 the hundred largest industrials had 1,438 directors, of whom 633, or 44 percent, were inside directors in the narrow sense, that is, employees of the company or one of its subsidiaries receiving at least $40,000 per year. Most of these employees were full timers; a handful were consultants. Correspondingly, in the broadest sense, 805, or 56 percent, of these 1,438 directors were “outside” directors. Row 1 shows that 80 (5.6 percent) of the 1,438 directors were former employees of the company, a surprisingly small number, substantially below that given by the Conference Board, whose studies have shown 15 to 20 percent of the total number of directors as “former employees” of the company. The Conference Board, however, has included many companies smaller than those in our sample.

Until very recently, the Conference Board surveys of director composition defined an inside director as one who was an employee of the company at the time of the survey. The 1973 edition of \textit{Corporate Directorship Practices: Membership and Committees of the}
### Table 2.5. Director characteristics of the 100 largest industrials, 1975

<table>
<thead>
<tr>
<th>Director category</th>
<th>Number (gross)</th>
<th>Percentage of all directors</th>
<th>Percentage of all directors in each category</th>
<th>Outside directors (subtracting previous row from total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total directors</td>
<td>1,438</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inside directors</td>
<td>633</td>
<td>44.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outside directors</td>
<td>805</td>
<td>56.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Former employee</td>
<td>80</td>
<td>5.6</td>
<td>79</td>
<td>726</td>
</tr>
<tr>
<td>2. Relative of key insider</td>
<td>5</td>
<td>0.3</td>
<td>3</td>
<td>0.2</td>
</tr>
<tr>
<td>3. Affiliated with another company doing substantial business with this company</td>
<td>157</td>
<td>10.9</td>
<td>154</td>
<td>10.7</td>
</tr>
<tr>
<td>4. Affiliated with another company doing small or uncertain volume of business with this company</td>
<td>150</td>
<td>10.4</td>
<td>130</td>
<td>9.0</td>
</tr>
<tr>
<td>5. Director on outside board with key insider or with outside business ties</td>
<td>274</td>
<td>19.1</td>
<td>93</td>
<td>6.5</td>
</tr>
<tr>
<td>6. Director socially linked to key insider</td>
<td>335</td>
<td>23.3</td>
<td>100</td>
<td>7.0</td>
</tr>
<tr>
<td>7. Director a substantial stockholder of company (100,000 shares or more)</td>
<td>63</td>
<td>4.4</td>
<td>24</td>
<td>1.7</td>
</tr>
<tr>
<td>8. Director on board at least 10 years</td>
<td>235</td>
<td>16.3</td>
<td>60</td>
<td>4.2</td>
</tr>
<tr>
<td>9. Director on over six boards</td>
<td>240</td>
<td>16.7</td>
<td>46</td>
<td>3.2</td>
</tr>
</tbody>
</table>
Table 2.5. (cont.)

<table>
<thead>
<tr>
<th>Director category</th>
<th>Number of all directors (gross)</th>
<th>Percentage of all directors in each category&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Outside directors (subtracting previous row from total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Director is representative of charitable or educational institution</td>
<td>69</td>
<td>4.8%</td>
<td>21 1.5 95 6.6</td>
</tr>
</tbody>
</table>

<sup>a</sup>Many outside directors appear in the various rows more than once – they may be officers of a company doing business (rows 3 and 4) and on another board in common with a key insider (row 5) and otherwise socially linked to a key insider (row 6). This column adds directors in each category as we proceed downward only where the director was not already counted in another row. Thus the sum of column 3 – 710 – indicates that many of the 805 outside directors fall into at least one of the categories shown on rows 1 to 10 and that only 95 of the 805 (as shown in the last row of column 5) do not appear on any row at least once.

<sup>b</sup>Includes narrow insiders only, defined as employees of the company or one of its subsidiaries, earning $40,000 or more per year.

*Board,* "in response to comments by users of the reports that former employees are really insiders for all practical purposes," finally treats former employees as insiders, although still retaining the old classification system for purposes of comparing inside-outside trends from 1967-1973. Former employees are plausibly still insiders, with close links to the successor management; in a majority of cases, former employees are reliable supporters of management. In a significant minority of cases, however, the former top officers either retain their previous dominance or become an independent power force, operating with a knowledge and prestige base that make them, if not effective "outsiders," formidable independent insiders capable of asserting alternative courses of action. Nonetheless, for the most part, retired officers remaining on the board are tied to the new management and serve as reliable allies.

Relatives and (especially) personal friends of insiders are hard to
identify on the basis of publicly available information. Table 2.5 lists only five directors (0.3 percent) as relatives of key insiders (row 2), surely an understatement. Friendships might be associated with social linkages through common membership in clubs, and almost a quarter of the directors were so connected with the insiders, as shown on row 6. A personal relationship might also arise out of the many cases where an insider was also on at least one other outside board with an outside director, as was true for 274 directors of the 100 largest industrials in 1975 (row 5). These are "iffy" matters, however – club memberships may not be used or may involve very limited contact with other members, and multiple common board memberships, although suggesting a greater likelihood of personal relationship, do not inevitably lead to a comradely feeling. But these, and many other bases of personal contact between insiders and outside directors – including doing business (rows 3 and 4) and long tenure on the board (row 8) – make for unquantifiable but certainly numerous friendships and personal loyalties that tie outside board members to corporate insiders.50

A great many outside directors of business corporations do business with the companies on which they serve as an outside director. Securities and Exchange Commission (SEC) proxy rules require disclosure in annual proxy statements of "any transactions [in which directors or officers] have a direct or indirect material interest," so that the proxy statement provides a valuable though seriously incomplete source of information on this matter.51 Proxy statements show, for example, that George Jenkins, an outside director of Bethlehem Steel, was the CEO of Metropolitan Life when it sold approximately $20 million of insurance to Bethlehem in 1974. American Cyanamid outside director, Ian McGregor, was CEO of Amex when it sold $2 million of its products to Cyanamid in 1974. Outside director of Alcoa, Edmund E. Carlson, was CEO of United Airlines when it participated in a joint venture hotel-ownership arrangement with Alcoa, and received, in addition, $5 million in 1974 in lease rentals from a subsidiary of Alcoa. An outside director of American Airlines, William O. Beers, was CEO of Kraftco, which the American Airlines proxy statement says supplied American with packaged goods of unspecified volume in 1975. Beers was also an outside director on the board of Manufacturers Hanover Trust of New York, an important bank to Kraftco, which received $312,796 in interest and fees from the bank in 1974. At the same time, John McGillicuddy,
president of Manufacturers Hanover, was an outside director on the board of Kraftco.

The number of these business relationships as shown by proxy statements alone is quite impressive and would radically alter the proportion of inside to outside directors if customer/supplier outsiders were reclassified as inside directors. In the case of Cleveland Electric Illuminating Company, for example, the ratio would change from three inside to eight outside, to seven inside to four outside. Overall, Table 2.3 shows that at least 157, or 10.9 percent, of the directors of the 100 largest industrials were affiliated with a firm doing a substantial volume of business with the company on which they served as a director.\(^{52}\) Another 150 directors (10.4 percent) were associated with companies doing a small or uncertain volume of business. Thus 21.3 percent of the sampled directors were customers or suppliers of the company on which they were directors, a figure surely understating the actual number. The independence of customer/supplier directors is often constrained by several factors: (1) They may have come on the board following the development of a personal tie with members of the inside management; (2) They are in a commercial nexus with the existing management that makes the decisions to buy and sell, and the maintenance and expansion of this business relationship, potentially sensitive to behavior (support and reliability) at board meetings; (3) Board directorships may be reciprocal (as in the Kraftco-Manufacturers Hanover case previously noted), which implies a further degree of connection and interest that enhances the probability of mutual understanding and support.

An important reason that bankers and other businesspeople go on boards is to protect, enhance, or bring into existence a business relationship. Two high officers of two different top banks explained to this writer that, after repeated solicitation, they had recently joined the boards of major corporations with great reluctance—the work was onerous, the personal advantages were minimal—but the bankers both gave way for fear of offending the customer and thus adversely affecting customer relationships. A director going on to a board for such an accommodating and business-protective purpose is not going to be a "boat rocker" or very independent. But at a certain point, managerial nonperformance may cause the banker's interest in solvency to outweigh the ties of reciprocity and the tacit agreement that the inside management has final authority. Under such circumstances, the banker may have a capacity to act and a degree of influence not available to the many still more dependent outside directors on the board.
Control and Strategic Position

Table 2.6. Principal occupations of outside directors of 511 manufacturing companies, 1972

<table>
<thead>
<tr>
<th>Position</th>
<th>Excluding former employee</th>
<th>Including former employee</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>Corporate executive</td>
<td>1729</td>
<td>63.9</td>
</tr>
<tr>
<td>Consultants</td>
<td>145</td>
<td>5.4</td>
</tr>
<tr>
<td>Lawyers</td>
<td>145</td>
<td>5.4</td>
</tr>
<tr>
<td>Retirees</td>
<td>325</td>
<td>12.0</td>
</tr>
<tr>
<td>Former employees</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>All other</td>
<td>358</td>
<td>13.3</td>
</tr>
</tbody>
</table>

*a Sum of following principal occupations: president; managing partner; board chairman; vice-president, executive/senior vice-president; chairman of a board committee; vice-chairman or honorary chairman; senior managing director; corporate officer (other than president, etc.).

*b Exclusively of former employee. The great majority of them are retired businessmen.

*c Number here based on a sample of 508 rather than 511 manufacturing companies.


A large number of outside directors of companies are jointly on the boards of still other companies with insiders, and in many cases they are on the insider's board as a result of their getting to know, like, and trust one another in this outside connection. For example, in 1970, J. F. Forster, CEO of Sperry Rand, joined the board of Borden, whose board included J. D. Finley and Shelton Fisher. In 1971 J. D. Finley became a member of the board of Sperry Rand. In 1972 Shelton Fisher became a board member of Sperry Rand. This sequence is found time and again and suggests a selection process based at least in part on personal relationships reminiscent of the enlargement of the membership of a club.

The "club" in this instance is the community of like-minded and mutually sympathetic businessmen and selected friends and allies among the nonbusiness elite. Despite the changes in board composition in recent decades, business executives still comprise the great bulk of outside directors. Table 2.6 shows that a majority of outside directors in the early 1970s were active corporate exec-
utives. Retired corporate officers, former employees, consultants, and lawyers, who often provide special and personalized services to these companies, comprised another 35.7 percent (including former employees) or 22.8 percent (excluding former employees) of outside directors. The residual proportion of outside directors is under 15 percent of the total. The interconnections between directors among boards and in other external linkages add force to the "club" concept of corporate boards, in which a community of ideological and material interests combine to make for a passive group of outside directors.53.

Table 2.5, also shows the number of directors who are substantial stockholders (row 7), who have been on the board 10 years or more (row 8), who are on more than six separate boards (row 9), and who are primarily affiliated with charitable or educational institutions (row 10). Substantial stockholders with a large stake in the company's well-being and often close to the management group may be considered insiders in some cases, but they are often there to protect their interests and their expertise, wealth, and status may give them more independence of management than many other directors.54 Long tenure as director also works both ways, tending to cement relationships with management, but, too (sometimes), to add prestige and power based on knowledge and closer links with other outside and inside directors. A director who holds numerous multiple directorships may have greater knowledge and experience as a director but may also have limited time and a vested interest in avoiding a reputation as a troublemaker.

Professional directors sell their services to buyers. If the buyers are predominantly the top managements of major corporations, a reputation for intrusiveness, unseemly pressure, and boat rocking will spoil what has become a remunerative sellers market.55 The sheer number of directorships of professional directors also suggests a limited capacity for extended effort in connection with any single company. At a 1976 annual meeting of Eastman Kodak, a stockholder noted from the floor that then director Juanita Kreps, a vice-president of Duke University, was on 13 boards of directors (six corporate, the others nonprofit), and question was raised concerning her ability to contribute much as an Eastman Kodak director.56 Professional director Don Mitchell, on 12 boards in 1970, was still able to devote half time to serving as CEO of the American Management Association.57 Joseph Needham, former chairman of the New York Stock Exchange, and subsequently a pro-
fessional director, was quoted in late 1979 as saying that "the classic clubroom type of board is not the way it works anymore," the accompanying news report noting that Needham devotes "much of his time to his dozen directorships."  

Representatives of charitable and educational institutions (row 10) are among the more independent outside directors, but they suffer from lack of expertise and their independence is somewhat compromised by the fact that they are in constant search for sustenance from the business community. They do not have a strong power base and are seldom boat rockers.

Thus a very large proportion of "outside directors" have ties and obligations to insiders that are likely subtly to compromise their independence. In an uncorrected view of the distribution of directors, Table 2.5 shows that 56 percent of the directors of the 100 largest industrials are "outside directors" in the broadest sense of the term. If former employees, relatives of key insiders, and directors doing a great deal of business with the company (rows 1 to 3) are subtracted from the total for reasons of possible lack of independence, we can see in column 6 that the proportion of outside directors has fallen to 39.6 percent. If we move two rows farther down, removing from outside directors those who do some business with the company and those who are on other boards in common with inside directors, the proportion of outside directors falls to a quarter (24.1 percent). Depending on our assessment of the independence of the remaining categories of Table 2.5, it is evident that the outsiders of outside directors can be reduced to levels well below a quarter of the total.

The board selection choices that have produced this result are based in part on the tendency to select and associate with people with whom one is familiar and with whom the selectors are comfortable. It is also almost certainly a result of the interest of the power core of the corporations in establishing and consolidating their control - which calls for outside directors who are not very independent of the company, its dominant personalities, and its lines of influence.

When for some corporate purpose outside directors are selected who are not entirely known and reliable, and who represent outside constituencies that pose some threat to company autonomy - as in the case of Leon Sullivan and GM - the selection is usually made after the most careful evaluation of costs and benefits, a close consideration of whether the outsider will be satisfied with concessions the company is prepared to make in his area of inter-
est, and an estimate of the extent to which the prospective director
will abide by the rules of the director game or go over the heads
of the management and board to the general public.

In the mid- and late 1970s the number of representatives of non-
business constituencies on the boards of the large companies under
special study here was remarkably small. A distinction must be
made between the number of companies with a constituency rep-
resentative and the relative importance of constituency representa-
tives in the aggregate of directorships. Constituency representa-
tion was and is fairly impressive on the first basis, small on the
second. In a mid-1970s universe consisting of the 200 largest non-
financial corporations and the 50 largest financials, 112 of the 250
giants (44.8 percent) had at least one educator on their boards, 67
(26.8 percent) had a woman director. 42 (16.8 percent) had a foun-
dation/nonprofit organization representative, and 42 (16.8 percent)
had a black director. As a proportion of all directors, however,
these nonbusiness constituency representatives added up to un-
impressive totals. The largest category, educators, numbered only
108 out of a grand total of 3,060 directors59 of the 250 largest
companies, or 3.5 percent of the aggregate; and of 4,010 total di-
rectorships, 141 were held by educators, also 3.5 percent. Those
primarily affiliated with foundations and other nonprofit organi-
izations numbered 37, with 35 directorships, or 1.2 percent of di-
rectors and 1.4 percent of directorships. There were 56 women
directors in 1975, with 80 directorships, accounting for 1.8 percent
of directors and 2 percent of directorships. And only 23 of 3,060
(0.8 percent of the total) were black, with 44 directorships, or 1.1
percent of total directorships.60 The higher ratio of black and
women directorships to black directors and women directors re-
flects the above average duplication of directors in this category.

One black director (Jerome Holland) had seven directorships, the
most of any director among the 250, and two others had four
directorships each. There is some overlap between these consti-
tuencies, Patricia Harris, for example, adding one director and
four directorships to both the women and black categories. But
even disregarding the overlaps, these four large classes together
accounted for only 7.3 percent of large corporation outside direc-
tors and 8.0 percent of their directorships.

These numbers and proportions have increased since 1975.
Korn/Ferry's sample, covering a wider range of companies than
the very large company sample used here, shows a more than two-
fold increase in the number of companies with a woman director
between 1974 and 1978 (from 11.4 percent to 28 percent), and an almost 50 percent increase in the number of companies with "ethnic minority" representatives (from 10.7 percent to 15.1 percent). The 250 largest companies have undoubtedly also moved further in the same direction.

Outside director power is constrained not only by the relationships that compromise director independence and the sparseness and relative weakness of nonbusiness and constituency directors, but it is also limited by an information gap. The imbalance of expertise and detailed knowledge between inside and outside directors greatly weakens the powers of outsiders to initiate and even to react effectively. As noted by one outside director, "The reason I don't get involved . . . is that I don't have time to get the facts, and I prefer not to look stupid."62 In recent years there has been an enlargement of information provided outside directors, and a greater willingness on their part to ask serious questions, but, at the same time, the continued growth in size, diversification, and foreign expansion has enlarged the volume of relevant knowledge. It is not clear, therefore, that the knowledge imbalance has been affected at all. The problem is also made intractable by the fact that a large proportion of outside directors are full-time occupants of important positions elsewhere and, in the words of one such director, "barely have time to brush their teeth."63

The position of the potential boat rocker is further constrained by traditional rules and conventions of board behavior. A first rule of board behavior is that issues must be discussed within the group, without appeal over the head of the board to public opinion.64 This reduces the power of spokespeople for a larger public constituency to bring pressure from the outside on other board members. That threat may still exist, but it is minimized by careful selection of any outside constituency representative, as previously discussed. In the small group setting of a board meeting, top management normally dominates the drift by virtue of its usually accepted leadership/executive role, responsibility for putting up the agenda and leading the discussion, full-time responsibilities for plans and initiatives, and superior knowledge of company affairs. The top management also benefits from other features of small group interaction processes. People do not like to look foolish, and it is difficult for outsiders to pose questions of a challenging nature to knowledgeable persons without appearing superficial or incompetent. It is also considered bad form to ask questions that imply doubt about motives, competence, and honesty; or to ask
serious questions and make challenges out of the blue, without
discussing the matter beforehand with the top officers; or to go
behind the backs of management and organize cliques in opposi-
tion to management. When outside directors behave in this way,
they may be ostracized, made uncomfortable, and in the end asked
to resign, perhaps because of a newly recognized conflict of inter-
est.

In sum, directors in large mainstream corporations normally
tend to play a passive role, as invited guests, characteristically tied
to the inside hosts by some sort of personal or business relation-
ship. Outside director power is, in consequence, typically latent at
best, activated mainly in response to serious economic or political
setbacks to the company, which demonstrate serious management
ineptitude or malefiance that leave management in great disarray
and threaten corporate financial integrity and survival. Where a
number of prestigious outsiders are brought on to the board,
however, there is usually a tacit assumption that the management
will adhere to the established rules of the game and will perform
acceptably, thus justifying continued support. Outside directors
often have money at stake as lenders or owners or represent lender
or owners as fiduciaries, and as directors they accept a fiduciary
responsibility to the company and its shareholders. This does not
ordinarily cause outsiders to encroach seriously on management
discretion, but in a number of ways and in varying degrees, the
outsiders are the focal point of constraints on management. In pre-
senting their plans and results to the directors, the dominant insid-
ers must appeal to the outside directors in terms of commonly
accepted purposes and standards of evaluation. The outsiders'
standards of propriety and their expectations concerning perform-
ance must be met if their goodwill and respect are to be main-
tained. The outsiders are thus one of many constraints, ideologi-
cal and material, direct and indirect, that greatly influence
managerial ends and behavior.

Stability and instability of control via strategic position

Where controlling blocks of stock have been dissipated and a man-
agement/board collective has established effective control, the ear-
lier legal solidity of power would appear to have given way to a
less stable basis of control. A Robert Sarnoff (RCA) or a D. F.
Kircher (Singer), lacking any substantial stock-ownership base,
can be abruptly ousted from power in coups that could not easily
be brought against a Henry Ford II or a John Paul Getty. But the
publicity given to management ousters in corporate upheavals of
the RCA-Singer variety makes the control of a mainstream large
corporation appear more "up for grabs" than is really the case.
Some of the conditions making for instability of control in a man-
gerian enterprise - especially business decline and credit string-
gency - can also disrupt control of an owner-dominated com-
pany, even one subject to majority-ownership control.68 It seems
plausible, however, that the more stock owned by the control
group, and the more diffused the ownership of the balance of the
stock, the easier it will be to maintain control. Where ownership
control in the form of direct involvement in management has
given way but the ownership interest remains substantial, and the
top insiders are, in effect, hired managers - or at least not yet free
of the latent power of large owners (e.g., Gulf) - management
tenure should be more precarious than in cases of pure manage-
cent control (e.g., GM) or of direct owner-management control
(Ford before 1979). The hired manager can be fired, whereas un-
der pure management control or direct ownership management
the top managers must fire themselves, or more potent forces
must be mobilized to bring about their ouster.
Stability of tenure is hard to measure. "Involuntary" ousters are
difficult to distinguish from normal turnovers - the basis and
power source of a change are not always identifiable, and there is
no generally accepted valid measurement to correct for differences
in actual versus potential performance. Robert Sorenson tried to
standardize for performance in measuring stability of tenure by
examining turnover rates of firms that experienced extended pe-
riods of profit decline. He found that the turnover rate of top man-
gerers was significantly higher under management control than un-
der owner control.69 William A. McEachern points out that
Sorenson does not distinguish between ownership-control cases
where the dominant owner is also the top manager (and is thus
not easily displaced) and where dominant ownership operates
through a hired manager.70 This is a valid point - that managers
hired by large, dominant owners may have greater insecurity of
tenure than controlling managers - but it fails to dislodge the find-
ing. Averaging together dominant owners (who could replace
themselves) and hired managers, as Sorensen does, tenure under management control appears to be less stable.71

Great size is clearly an important control-stabilizing factor. The rate of involuntary ouster appears to be inversely related to size. By virtue of their size, giants such as AT&T, General Electric, and Mobil Oil are almost out of reach of the takeover process, which would require enormous resources and the overcoming of considerable powers of resistance. At the turn of the century a company as large as Union Pacific could be seriously concerned about takeovers, via stock market raids, despite substantial insider holdings.72 This is still a matter of concern for large companies, but not for the largest. Only four of the 200 largest were subject to takeover bids in the years 1965-1975, and not one of the 100 largest companies as measured by asset size was subject to an actual takeover offer. One of the four bids among the second 100 was successful – Marcor was taken over by Mobil Oil in 1974–1975. The tender offer by Mobil was supported by the Marcor management, so the transaction was more like a merger than an involuntary ouster from the outside. The Crane assault on Anaconda was opposed and defeated, but at the cost of Anaconda’s eventual absorption in 1976 by the “white knight” Arco. Two other takeover efforts, one of Goodrich by Northwest Industries and one of Signal by the Bronfman (Seagram) interests, were defeated. Occidental Oil was threatened with a takeover by Standard of Indiana, but the threat never materialized into an actual bid. The takeover threat has extended pretty far upward in the list of the largest companies, reaching Babcock & Wilcox, CNA, and Anaconda, and threatening Occidental, but it is still mainly a problem of the smaller fry.73

Business performance is clearly a major factor affecting the stability of control via strategic position. Rapid or at least respectable growth in earnings per share, a high rate of return on owners’ equity and assets, and a minimum of liquid low-yield assets redeployable by an aggressive conglomerator enhance management power and stability, as they reduce the likelihood of an external raid and strengthen inside management’s bargaining position vis-à-vis large and small stockholders, creditors, employees, and the board of directors.

The stability of control by strategic position can also be undermined by the occurrence of corporate traumas that are unconnected with declining performance. Revelations of illegal acts, se-
rious conflicts of interest brought to light, major antitrust actions—reduce the prestige of management, threaten it with legal action and negative publicity, and adversely affect organizational unity and morale. They provide the vehicles through which opponents of the management may organize attacks against it. The Dorsey management of Gulf Oil was ousted following a corporate trauma that unleashed latent antimanagerial forces that were not only disturbed by the adverse publicity but were also disenchanted by Gulf’s economic performance over the prior several years.

Length of tenure of the top inside management also affects stability of control. Rule by strong and dominant personalities makes for stable control. But the unexpected death or retirement of a dominant manager may create a power vacuum. Sometimes the “retired” executive retains power and attempts to maintain partial or complete rule. This can further destabilize control, as consolidation of managerial control may be impeded and displacement may more readily occur as a result of independent board action.

With new or weakened managerial control there may be an extended period of maneuvering among the members of the board, shifting coalitions, hirings and firings of new high-level officers, and general instability, as in the case of United Brands following the suicide of Eli Black. The unexpected death of a top manager or ouster based on unsatisfactory business performance suddenly puts a great deal of power into the hands of the board of directors, and control sometimes becomes fluid. It is in periods of transition, when the old top management team has been dislodged and the new one has not yet established a reliable board/employee/external constituency base, that the locus of control is relatively uncertain and hence unstable. Such instability may be prolonged if the new management group is unable to build strength on the basis of renewed company prosperity.

In the typical mainstream managerial giant, the size, diversification, infrequency of sustained and control-threatening losses, and the strategic position of the top management make for a generally high degree of stability of control. A coalition of top insiders—with varying distributions of power between the CEO and other high officers—normally manages the succession process of such companies with a minimum of trauma or necessity for any outside director intervention. This is usually true for the mainstream giants even in times of trouble—as in the case of Westinghouse in the early 1960s and 1970s and the Chrysler Corporation.
in 1970 and 1974. Instability is the exception, often associated with unusual financial distress, or, more frequently, the termination of one-man rule.

Concluding note

Strategic position is the crucial underpinning of management control of the large corporation. It rests on daily and direct management command over personnel and resources, knowledge, the importance of managerial and organizational skills, and the structural and social relationships that develop on the basis of proximate command. The power lacunae left by the diffusion of ownership is gradually occupied by those who exercise power on a daily basis and who are thereby well positioned to consolidate it more firmly over time. Management's control is facilitated by its domination of the board selection processes and the resultant capacity of top officials to mold boards into friendly and compliant bodies. The recent increase in number and proportion of outside directors, and the shift in director composition, has not altered this pattern to any significant degree.

Management's domination is not total, however – the owners do not disappear, nor do the lenders. In the three chapters that follow I examine the major external sources of influence on corporate managers – owners, bankers, and government – and assess the extent to which they shape and constrain corporate goals.